

## ANALYSIS OF AMENDED BILL

Author: Assm. Rev. & Tax Comm. Analyst: Jeff Garnier Bill Number: AB 1208  
Related Bills: AB 2797 (1998) Telephone: 845-5322 Amended Date: 05/28/99  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Conformity Act of 1999

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 19, 1999 STILL APPLIES.

OTHER - See comments below.

### SUMMARY OF BILL

The Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), in general, conform to the Internal Revenue Code (IRC) either by incorporating the IRC by reference as of a "specified date" or by stand alone language which mirrors the federal provision. California law is conformed to the IRC as of January 1, 1998, unless a specific provision provides otherwise. This bill would change the specified date from January 1, 1998, to January 1, 1999, for taxable and income years beginning on or after January 1, 1999. Changing the specified date automatically conforms to all changes from January 1, 1998, through December 31, 1998, to IRC sections that have been previously incorporated by reference. Thus, California law would conform to numerous changes made to federal income tax law by the IRS Restructuring and Reform Act of 1998 and certain other federal acts enacted during 1998.

This bill also would make numerous changes to specifically not conform or modify certain items in the IRC. Additionally, numerous technical changes regarding cross references and the deletion of unnecessary language that was used to conform to federal law changes subsequent to January 1, 1998, and prior to January 1, 1999, are being made by this bill.

### SUMMARY OF AMENDMENT

The May 28, 1999, amendment would conform California law to two additional federal items that were not contained in the prior version of the bill: increasing self-employed health insurance deduction to 60% and allowing certain B&CTL taxpayers to elect to expense the cost of certain depreciable assets in an amount up to \$17,000 per year. This analysis discusses only these two changes in the bill, which are shown below as items 12 and 13.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	<u>_____ X</u> PENDING

Department Director

Date

**Gerald Goldberg**

**6/10/1999**

EFFECTIVE DATE

Unless otherwise specified, this bill would apply to taxable and income years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

12. Self-Employed Health Insurance Deduction Increased to 60%.

**Existing federal law** provides for a deduction in determining adjusted gross income (AGI) of 60% (effective for 1999) of a self-employed individual's cost for health insurance. Federal law also allows the deductible percentage to increase incrementally to 100% beginning in the year 2003. The percentage is increased as follows:

1999 through 2001	60%
2002	70%
2003 and thereafter	100%

**California law** provides for 40% of the cost of a self-employed individual's cost for health insurance to be deductible in determining AGI.

**Under both** federal and state law, "health insurance costs" include premiums paid for health insurance of the taxpayer, taxpayer's spouse and dependents. Certain qualified "long term care premiums" are also considered health insurance.

Additionally, **under both** federal and state law, a deduction for health insurance for self-employed individuals is not allowed from gross income if the individual or individual's spouse is eligible to participate in any subsidized health plan of any employer of the individual or individual's spouse. The deduction from gross income is limited to the extent of the individual's federal earned income from the business from which the health coverage was established.

Finally, **under both** federal and state law, the cost of health insurance incurred by a self-employed individual that is not deductible in determining AGI may be taken as an itemized medical deduction. Itemized medical deductions are limited to the amount that exceeds 7.5% of the taxpayer's AGI. All individuals may deduct health insurance costs paid by the individual, which are not excluded from income, as an itemized medical deduction subject to the 7.5% AGI floor.

**This bill** would increase the percentage of health insurance deductible by self-employed individuals to 60% for 1999, and thereafter.

13. Election to Expense the Cost of Certain Depreciable Assets Permitted Under the B&CTL.

**Federal law and PITL** provides that in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment in depreciable assets may elect to currently deduct, rather than capitalize and depreciate, up to \$19,000 of the cost of qualifying property placed in service in a taxable year beginning after December 31, 1999. In general, qualifying property, commonly referred to as section 179 property, is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.

The limitation amount is reduced (but not below zero) by the amount by which the cost of section 179 placed in service during the taxable year exceeds \$200,000.

In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of any trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

The **federal and PITL** expense amount increases from \$19,000 to \$25,000. The increase is phased in as follows:

Taxable year beginning in-	Maximum expensing
1999	\$19,000
2000	\$20,000
2001 and 2002	\$24,000
2003 and thereafter	\$25,000

**Under the PITL, California law** is currently in full conformity with the federal law section 179 deduction. Prior to 1999, the maximum amount allowed as a deduction under the PITL for section 179 was less than the federal amounts.

Under current **California law**, S corporations (and their shareholders) are allowed a section 179 deduction under the PITL. For income years beginning on or after January 1, 1999, an S corporation may elect to expense up to \$19,000 in the computation of the S corporation's measured tax (presently the S corporation tax rate for non-financial corporations is 1.5%.)

**Under the B&CTL, California law** does not conform to the federal law expensing provision but instead allows "additional first-year depreciation" of 20% of the cost (up to a maximum of \$10,000 per year) of qualifying property. Thus, a maximum expense deduction of \$2,000 per year is allowed. Property qualifying for the "additional first-year depreciation" is similar to property qualifying under section 179. Prior to the enactment of the present day section 179 deduction, "additional first-year depreciation" was the federal rule.

**This bill** would conform the California B&CTL to federal section 179 deduction, with a lower maximum amount allowed as a deduction. Under this bill the maximum annual amount that could be expensed under the B&CTL would be \$17,000. This bill would not affect an S corporation's section 179 deduction.

Under the B&CTL, **this bill** also would make the federal election to expense items under section 179 binding for California purposes and a separate election would not be allowed.

#### Technical Considerations

Amendments I, II, III, and IV would make technical corrections clarifying a federal section 179 election must be made to allow the deduction for California purposes.

# FISCAL IMPACT

## Departmental Costs

This bill would not significantly impact the department's costs.

## Tax Revenue Estimate

Assembly Bill 1208 (As Proposed to be Amended)		Personal Income Tax			Bank & Corporation Tax		
		(in millions)			(in millions)		
	Description	1999-0	2000-1	2001-2	1999-0	2000-1	2001-2
1	Exclusion of value of meals to employee	(\$1)	(\$1)	(\$1)			
2	Employer Deductions for Vacation and Severance Pay a/	Minor Gain	Minor Gain	Minor Gain	\$2	\$3	\$3
3	Certain Trade Receivables Ineligible for Mark-To-Market Treatment	Minor Gain	Minor Gain	Minor Gain	\$12	\$18	\$18
4	Exclusion-Min. Req. Distributions from AGI for Roth IRA Conversions b/	-	-	-			
5	Farm Production Flexibility Contract Payments	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
6	Certain Deductible Liquidating Distributions of RICs & REITs c/				\$40	\$5	-
7	Tax Treatment of Cash Options for Qualified Prizes	Minor Loss	Minor Loss	Minor Loss			
8	Exclusion from Income for Employer-Provided Transportation Benefits	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
9	Payments Received Pursuant to the Ricky Ray Hemophilia Relief Fund Act	Insignificant	Insignificant	Insignificant			
10	Waiver of Estimate Tax Penalty	No Impact	No Impact	No Impact	No Impact	No Impact	No Impact
11	1998 Federal Technical Changes	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
12	Self-Employed Health Insurance Deduction at 60%	(\$21)	(\$19)	(\$25)	-	-	-
13	B & C Section 179 Expensing Allowance at \$17,000	-	-	-	(\$32)	(\$23)	(\$17)
	<b>TOTALS</b>	<b>(\$22)</b>	<b>(\$20)</b>	<b>(\$26)</b>	<b>\$22</b>	<b>\$3</b>	<b>\$4</b>

Minor = Loss or gain of less than \$500,000

a/ Baseline revenue gains are projected to be \$65 million for 1999-0 and \$3 million thereafter.

b/ Baseline revenue gains are projected to be \$84 million for 2004-5, \$101 million for 2005-6, and \$99 million for 2006-7. Conformity gains are estimated to be \$1 million annually beginning with the fiscal year 2004-5

c/ Baseline revenue gains are projected to be \$15 million annually beginning in 1998-9,

## BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1208  
As Amended May 28, 1999

AMENDMENT I

On page 35, line 8, insert after "(a)" and before "An election":

(1)

Amendment II

On page 35, line 9, insert after "Revenue Code":

for federal purposes

Amendment III

On page 35, line 10, after "shall be" and before "'an election", insert:

treated as

AMENDMENT IV

On page 35, between lines 14 and 15, insert:

(2) If a taxpayer fails to make an election for federal purposes under Section 179(a) of the Internal Revenue Code, relating to expensing certain depreciable business assets, no election under Section 179(a) of the Internal Revenue Code shall be allowed for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.